

CHAPTER VIII

CAUSES OF SICKNESS

One of the dissatisfying features of Indian industrial sector is the presence of a large number of sick units. Sickness results in locking of resources, wastage of capital assets, loss of production and increasing unemployment. It also affects in reduction of loanable funds by the financial institutions by reducing the velocity of funds. These blocks are not only because of the sickness in large and medium scale industries but also a big share of Small Scale Industries.

Causes of sickness in small industry have to be viewed from the general background of industrial economy. At a point of time problems of small industry are not uniform. However the following diagram I analyses clearly the causes of sickness in small scale sector.

Prakasam district is one of the backward districts of Andhra Pradesh where the growth of small scale industries are increasing year after the year. This growth in small scale industries is crippled by the increasing and alarming sickness in small industry.

DIAGRAM - I

SICK UNITS IN THE SMALL SCALE SECTOR-ANALYSIS OF CAUSES

A unit becomes sick when it cannot generate from its internal sources necessary working capital to permit continuous operation at the optimum level ; Internal cash generation is the most important indicator of the health of an unit.

LACK OF WORKING FUNDS
DROP IN INTERNAL CASH GENERATION

DROP IN PRODUCTION

POOR CASH MANAGEMENT

INCREASE COST OF PRODUCTION

- a. Deliberate diversion of funds
- b. Unplanned diversion of funds
- c. Poor collections
- d. Unplanned payment to creditors
- e. High inventory
- f. Unproductive expenditure

PROBLEMS OF PRODUCTIONS

LACK OF ORDERS

LACK OF RAW-MATERIALS

INCREASE COST OF RAW MATERIALS

INCREASED OVER HEAD COSTS

- a. Machine break-downs
- b. Poor quality of raw materials.
- c. Power shortages
- d. Poor labour productivity
- e. Delayed supply from sub contractors.
- f. Lack of production planning & Control
- a. Competition
- b. Recession
- c. Irregular deliveries
- d. Poor marketing effort
- e. Power shortage
- f. Govt. policies
- g. Improper planning for the lift of the products

- a. National or regional shortage
- b. High cost
- c. Overdue payment to suppliers
- d. Poor quantity in the supply
- e. Uncertainty in the market
- f. Lack of planning

- a. Increased cost of raw material
- b. Large orders book at fixed price in a inflationary market
- c. High material wastage.
- d. High inventory costs.
- a. Inefficiency in production
- b. Under utilization of capacity.
- c. Heavy borrowings and high interest charges.
- d. Increase administrative and selling expenses.
- e. Unplanned capital expenditure.

These small scale industries are being sick because of low or high severity of one or two or many problems at any time and even between the small units. In the light of the above a humble attempt is made in this chapter to discuss the causes of sickness in the selected small scale industrial units.

In order to know the causes of sickness in small industry in the 40 sick selected units a questionnaire is drafted and the entrepreneurs are asked to give the information relating their units. Based on the information given by them the following factors are observed as most important causes of sickness in their units.

1. Management deficiencies.
2. Marketing constraints/Competitive Market.
3. Shortage of Working Capital/Liquidity constraints.
4. Power cuts.
5. Labour problems
6. Raw Material Shortage.
7. Fluctuating demand for their products.
8. High cost of production.
9. Underutilisation of capacity.

10. Government Policies.

TABLE 8.1

CAUSES OF INDUSTRIAL SICKNESS IN THE SELECTED SMALL SCALE UNITS

| Sl. No. | Causes of sickness | Agro-based (20) | Mineral-based | Per cent tage (10) | Engine ring | Per cent tage (15) | Chemical based (5) | Per cent tage (40) | Total (5) | Per cent tage (5) |
|---------|--|-----------------|---------------|--------------------|-------------|--------------------|--------------------|--------------------|-----------|-------------------|
| 1. | Management deficiencies | 10 | 5 | 50.00 | 3 | 60.00 | 2 | 40.00 | 20 | 50.00 |
| 2. | Marketing constraints | 14 | 6 | 70.00 | 5 | 100.00 | 5 | 100.00 | 30 | 75.00 |
| 3. | Shortage of Working Capital/Financial deficiencies | 11 | 8 | 55.00 | 4 | 80.00 | 4 | 80.00 | 27 | 67.00 |
| 4. | Power cuts | 6 | 4 | 30.00 | 2 | 40.00 | 1 | 20.00 | 13 | 32.00 |
| 5. | Labour problems | 4 | 5 | 20.00 | 2 | 40.00 | 1 | 20.00 | 12 | 30.00 |
| 6. | Raw material shortage | 15 | 4 | 75.00 | 2 | 40.00 | 3 | 60.00 | 24 | 60.00 |
| 7. | Fluctuating demand | 3 | 2 | 15.00 | 2 | 40.00 | 1 | 20.00 | 8 | 20.00 |
| 8. | High cost of production | 7 | 6 | 35.00 | 5 | 100.00 | 3 | 60.00 | 21 | 52.00 |
| 9. | Under-utilisation of capa | 8 | 3 | 40.00 | 3 | 60.00 | 2 | 40.00 | 16 | 40.00 |
| 10. | Government policies | 5 | 3 | 25.00 | 4 | 80.00 | 2 | 40.00 | 14 | 35.00 |

Source : Field Study

The over all analysis of causes of sickness in 40 sick industrial units show that marketing constrains and financial deficiencies are the most important causes of sickness in small industry. 30 out of 40 selected sick units have marketing problem whereas, 27 units out of 40 have financial difficulties or shortage of working capital. Shortage of raw material, high cost of production and management deficiencies are also important causes for sickness in small industry. 24 out of 40 small scale sick units are facing the problems of raw materials while, 21 units are suffering from high cost of production and 20 units are facing the problem of inefficient management.

An individual analysis by type of industrial units also reveals more or less the same causes for sickness in industrial units.

1. Agro-based Units :

In Agro-based units 15 out of 20 selected sick units are facing the problem of raw materials while 14 units have facing the problem of marketing. Shortage of working capital and management deficiencies come third and fourth in the importance.

2. Mineral-based Units :

Out of the 10 selected mineral based sick units 80 per cent of units are facing the problem of working capital while 60 per cent of units are facing the problem of marketing and high cost of production as the causes of sickness. 50 per cent of units are facing the problem of management deficiencies and labour problems.

3. Engineering and allied products :

It is quite interesting to note that all the 5 selected sick engineering units have the problem of marketing as the main cause of sickness. High cost of production is one of the important causes of sickness in engineering industry. Shortage of working capital is the next important problem. 80.0 per cent of sick engineering units are facing the problem of working capital or suffering from financial deficiencies. Frequent changes in Government Policies are also an important cause for sickness in engineering units.

4. Chemical based Units :

Chemical based units have also stated that marketing constraints are the main cause of sickness in their units. All the 5 selected sick units claimed that marketing deficiencies are the cause of sickness in their units. Shortage of working capital is the second

important cause for sickness in chemical industry. Raw material shortage and high cost of production are also important causes for sickness in chemical industry.

Results of Case Studies :

It is observed that the factors most often responsible for sickness in small scale industrial units can be identified as marketing deficiencies. This may take the form of piling of finished stocks, locking of working funds in the finished products, low turn-over etc. Due to this marketing problems a unit is unable to survive in a highly competitive market. Another important factors which should be mentioned is the problem of finance or working capital or inadequate availability of funds which may be due to inefficient cash management.

This inadequacy in working capital may be attributed to poor cash management, deliberate diversion of funds, poor collection, unplanned payment to creditors and so on.

The non-availability or inadequate quantities of critical inputs such as power, essential raw materials etc., are also the major factor causing sickness in small industry. High cost of raw material, poor quality of raw materials are also contribute to the incidence of sickness.

Management deficiencies is also an important cause for sickness. This may take the form of poor production management, management of labour and poor resource management.

It is also to be noted that sickness in an industrial unit can not be attributed to a single and a particular factor alone, but it is the result of contribution of multifarious and multidimensional factors either inter-related or interdependent of each other.

Causes of Sickness by Industry and Unit :

Though the general causes of sickness for all the small scale industries are more or less the same there are certain specific causes of sickness for each of the selected small scale units. The causes of sickness of different industries unit-wise are discussed hereunder as disclosed by the entrepreneurs.

I. AGRO-BASED UNITS :

1. a. Non-availability of raw materials
- b. Inefficient management
- c. Diversion of funds for other purposes
- d. Insufficient working capital and difficulties in procuring orders
- e. Labour problems.

2.
 - a. Heavy competition from other units
 - b. Uncertainty in the supply of raw materials
 - c. Insufficient working capital
 - d. High cost of inventory
 - e. Chronic Power shortage
 - f. Poor capacity utilisation.

3.
 - a. Over estimation of demand
 - b. High cost of production
 - c. Under estimation of financial requirements
 - d. Inefficient management
 - e. Poor collection from debtors.

4.
 - a. Delay in bills realisation
 - b. Break-even point too high
 - c. Heavy competition from large units
 - d. Labour problems
 - e. Very high competition
 - f. Lack of proper technical capabilities.

5.
 - a. Increase in the prices of raw materials
 - b. Increase in administrative, sales and other expenses
 - c. Working capital requirements
 - d. Shortage of trained man power
 - e. Severe competition from large units.

6.
 - a. Working below break-even level
 - b. Lack of proper inventory management
 - c. Poor sales realisation and management
 - d. Lack of product mix
 - e. Poor maintenance of machinery.

7.
 - a. Frequent Power cut
 - b. Lack of proper inventory management
 - c. Insufficient working capital
 - d. Unproductive expenditure
 - e. Delay in bills realisation
 - f. Low capacity utilisation.

8.
 - a. Poor maintenance of machinery
 - b. Dependence on a single customer which resulted in over-stocking position
 - c. Lack of sales and orders.

9.
 - a. Too much rejection due to poor quality
 - b. Low capacity utilisation
 - c. Poor cash generation due to low sales.

10.
 - a. Poor quality of the products which resulted in market failure
 - b. Non-availability and shortage of raw materials
 - c. Frequent power cut
 - d. Poor resource management.

11. a. Long delay in payment of the customers
b. Poor maintenance of plant and machinery
c. Abrupt changes in Govt. policies.
12. a. No technical feasibility study
b. Non-availability of raw materials
c. Lack of interest on the part of the partner.
d. Unnecessary delay in commencing production.
e. Wrong selection of location
f. Over estimation of demand/poor planning
g. Poor maintenance of plant and machinery
13. a. Under-utilisation of capacity
b. Shortage of raw materials
c. Steep decline in the demand for the product
d. Poor cash generation due to failure of sales
e. Lack of sales and orders.
14. a. Lack of working capital
b. Heavy power cut
c. Insufficient availability of raw material
d. Diversion of money from plant and machinery to construction
e. Mismanagement
f. outdated production process.
15. a. Poor quality of the products affected the demand for the product

- b. Encouraging too much outside liability resulted in accumulated losses
 - c. Delay in commencement of production due to delay in arrival of an important component
 - d. Working capital requirements.
- 16.
- a. Non-availability and shortage of raw materials
 - b. Frequent changes in management
 - c. High cost of inventory
 - d. Poor technical know-how
 - e. Poor cash generation and management
 - f. Market failure due to poor quality.
- 17.
- a. Competition in the market from the large units and other units
 - b. Insufficient working capital resources
 - c. Due to market failure inventory is accumulated which resulted in heavy interest burden and financial losses
 - d. Lack of demand for the product resulted in poor sales turnover
 - e. Lack of technical man power.
- 18.
- a. Lack of working capital
 - b. Inefficient management
 - c. Failure to procure sufficient raw materials
 - d. Poor maintenance of machinery
 - e. Under-utilisation of capacity.
- 19.
- a. Poor quality of raw materials
 - b. Uncertainty in the supply of raw materials

- c. Weak market organisation
 - d. Booking of large orders at fixed prices in an inflationary market
 - e. General financial indiscipline
20. a. Underestimation of financial requirements
- b. Increase in prices of raw materials
 - c. High cost of inventory
 - d. Low sales generation
 - e. High cost of production.

II. MINERAL BASED UNITS :

- 1. a. Misuse of finance and other resources
 - b. Under-utilisation of capacity
 - c. Acute shortage of basic raw materials
 - d. Diversion of funds for personal uses
 - e. Lack of technical know-how in the implementation of the project
 - f. Low market prices for the units
 - g. Poor resource management.
2. a. Non-availability of raw materials
- b. Managerial inefficiency
 - c. Delay in bills realisation
 - d. Under-utilisation of capacity
 - e. Under-estimation of financial requirements.

3. a. Non-availability of raw materials
b. Labour problems
c. Shortage of working capital
d. High cost of production
e. Government policies
4. a. Managerial inefficiency
b. Increasing labour problems
c. Power cuts
d. Marketing problems as there is heavy competition from other units.
5. a. Mismanagement of working capital
b. Over-estimation of demand
c. High cost of production.
6. a. Falling prices of finished products due to more number of new units
b. Cut throat competition from other units
c. Increasing prices of raw materials
d. Increasing demand for working capital
e. Excessive inventory management
f. Increase in interest burden.
7. a. Delay in commencing production is power connection not being available
b. Under-utilisation of capacity
c. Labour problems.

8.
 - a. Paucity of funds in working capital
 - b. Unproductive expenditure
 - c. lack of market feed-back and market research

9.
 - a. Labour problems
 - b. Shortage of Power supply
 - c. Disputes among the promoters of the units
 - d. Frequent breakdown of machinery resulted in huge costs on repairs and servicing in addition to stoppage of production.

10.
 - a. Poor cash generation due to low sales
 - b. Under-utilisation of capacity
 - c. Shortage of raw materials
 - d. Poor inventory management
 - e. Unplanned capital expenditure.

III. ENGINEERING AND ALLIED PRODUCTS :

1.
 - a. Non-availability of raw materials
 - b. Marketing problems as there is heavy competition from large scale units
 - c. Delay in commencement due to power failure
 - d. Under-utilisation of capacity
 - e. Inefficient management
 - f. Working capital requirements.

2.
 - a. High rate of interest due to too much of outside liabilities
 - b. Under-utilisation of capacity

- c. Increased raw material costs
 - d. Delay in payment and clearance of bills by the banks
 - e. High cost of production.
- 3.
- a. Poor maintenance of accounts
 - b. Lack of technical know-how
 - c. Poor knowledge about the market
 - d. Over-estimation of demand
 - e. Lack of funds for expansion and for working capital requirements.
- 4.
- a. Market failure due to lack of experience in this line.
 - b. Financial constraints, under-estimation of financial requirements
 - c. Inefficient management resulted in poor planning.
 - d. High cost of production
 - e. Problems in marketing the product
- 5.
- a. Lack of Salesmanship and lack of orders
 - b. Lack of market feed-back and market research
 - c. Deliberate diversion of funds
 - d. Poor collection from debtors
 - e. High cost of production.

IV. CHEMICAL BASED UNITS :

1. a. Frequent power cut
b. Under-utilisation of capacity
c. High incidence of cost of production
d. Shortage of raw materials
e. Marketing constraints
2. a. Poor quality of the products
b. Power cuts and power shortage
c. Under-utilisation of capacity
d. High cost of production
e. Lack of infrastructural facilities
f. Low prices for the products due to defective production which resulted in continuous losses.
3. a. Inefficient management
b. Poor maintenance of plant and machinery results in heavy cost of repairs
c. Lack of working funds
d. Failure to compete in the market
e. Poor sales realisation and management.
4. a. Increasing prices of raw materials
b. Lack of proper planning
c. Abrupt changes in Government policies
d. Heavy borrowing yet shortage of working funds
e. Lack of technical knowledge to implement the project.

5. a. Poor maintenance of machinery
- b. Poor inventory management
- c. Unplanned capital expenditure
- d. Under utilisation of capacity
- e. General financial indiscipline.

Remedial Measures :

The Government has been playing a significant role in the rehabilitation of sick industrial units. The magnitude and incidence of industrial sickness is a matter of serious concern for the central and State Governments, Reserve Bank of India, Banks and Financial Institutions.

1. Industrial Reconstruction Corporation of India (IRCI):

This corporation was setup in 1971 mainly to fortify the industrial structure for the provision of reconstruction and rehabilitation assistance to sick and closed industrial units.

2. Tandon Committee :

A study group appointed by the Reserve Bank of India to frame guidelines for followup of bank credit has also recognised the need for the banks to include in the rehabilitation proposals of sick industrial units,

financial/structural reorganisation and also intervention by the banks in the management of sick industrial units¹.

3. Financial Institutions :

The financial institutions are also engaged simultaneously in providing to sick industrial units, reliefs such as additional financial assistance, reschedule of existing loans, conversion of short-term liabilities to long-term liabilities. Due attention is also paid to aspects like management deficiencies and imbalances in technical and production levels as part of rehabilitation packages. In order to achieve effective monitoring and nursing of sick industrial units, the financial institutions have setup separate rehabilitation cells in their respective organisations manned by suitable personnel with suitable technical, financial and managerial capabilities.

4. H.N. Ray Committee :

It has recommended the merger of sick viable units with sound units and thereby revival of those units.

1. Tiwari Committee Report, Reserve Bank of India, Bombay, 1984.

In November, 1976 the Reserve Bank of India advised the banks to setup special cells at their important regional centres for rehabilitation of sick industrial units.

Rehabilitation of Small Scale Industrial Units :

In respect of small scale industrial units, the Reserve Bank of India has drawn the attention of the banks to revamp the organisational arrangements at their regional offices and at centres where financing of small scale industrial units is concentrated and to setup regional cells to render the necessary monitoring and counselling assistance. Where sickness is due to lack of power and raw materials etc., the banks are advised to refer such cases to the state level corporation committees which had representatives from the banks and financial institutions etc.

Selection of units for rehabilitation :

In selecting a unit for rehabilitation or revival, the financial institutions or banks must be very careful. Where a unit is too sick to be revived either because of lack of demand for its products, or its technology has become outdated the units should be allowed to die.

Any criteria they felt for take over, rehabilitation, reconstruction of a unit should be based only on

economic considerations. Any continued assistance to economically unviable units would result in scarce funds being diverted from economically productive purposes, which would be counter productive to the nation as a whole. Assistance should therefore, be given, only to those units where there is possibility of revival within a time frame work of 3 to 5 years.

A unit is considered viable if it is in a position to service its debts at a reasonable rate of interest which will be concessional but not below the minimum lending rate and in no case below the cost of funds to the banks with a reasonable period say about eight to ten years.

Though so much has being done by the Government through its banks, financial institutions, guidance cells, rehabilitation cells and so on, yet there is something concrete to do by these institutions to rehabilitate the sick small scale industrial units.

The Government, banks and financial institutions should focus not only on revival of sickness in small industry but also on prevention of sickness.

Any new or existing industrial unit have to consider mainly five factors before they start their

operations. These are suppliers of raw materials and services, buyers of output, threats from substitute, possibility of new entrants and competition from existing units. Understanding of how these forces act is very important for a unit to operate competitively.

Identification of products having market opportunity and input factor availability is the most important activity. In an economy such as India where every business has to comply with various Government requirements, an understanding of procedure, to be complied with and their implications on business operations are necessary. Besides socio-economic and political atmosphere has to be watched carefully before plunging into business.

An ideal approach will include a thorough understanding of the strength and weaknesses of the entrepreneurs and relating them to the environmental opportunities and threats. It is not a one time activity but a continuous evaluation of the operations and strategies of the unit is called for to maintain a competitive edge.

Identification of commercially viable unit is one of the most difficult tasks for an entrepreneur.

Although it looks simple that one can choose any one of the innumerable products listed by various consultancy organisations, final selection of products based entirely on general observation of market is dangerous.

The entrepreneur will have to frame an idea that so and so products are to be produced and some consultant may be asked to prepare detailed project report.

Lured by the official publicity for industrial incentives, several innocent people decide to start industries. Several of them hardly have any idea about the nature of the product they should pursue. They blindly go by the advise of friends, consultants and officials of promotional institutions and there by starting the unit, find it difficult to run, and shuts the doors of the unit.

Environmental factors are also to be considered before starting a unit. The factors may be divided into two. Those factors immediately affecting the unit and those not. Availability of raw material and their prices, supply of skilled labour and wage level, market for products, infrastructural facilities, local tax structure and institutional support and other facilities are some of the critical variables to be considered

while choosing a product. Every entrepreneur has to develop a strategy to manage these environmental variables bearing in mind the extent of risk one can take.

If the above things are carefully taken into consideration by the prospective entrepreneurs there is only limited possibility of a unit being become sick. Lending institutions also have to bear in mind or study the above factors of the unit and lend accordingly. Then they can prevent sickness to the largest possible extent.

Summary of Recommendations to revive Sick Small Scale Industrial Units :

Timely detection of symptoms of sickness in small scale industry and formation of nursing programme is an essential requisite at the incipient stage itself. There should be periodic exchange of information about the financial status of the unit between different agencies.

1. Financial Institutions :

Should made some sacrifices to the possible extent such as conversion of term loans into owners equity, reduction of owner's equity, postponement of overdue interest, conversion of over due interest into term loan, reduction and concessional rate of interest etc.

2. Central Government :

Should provide certain special concessions to these sick industrial units by exempting the unit from paying central excise, exemption from interest tax and income tax. And extension of market support by reserving certain quota for purchase of sick industrial units.

3. State Government :

May assist sick small industrial units in the form of ensuring preferential treatment in respect of power supply, concessions in power tariff for a specific period, timely supply of raw materials to the required extent, exemption or concessions in the rate of sales tax, speedier disposal of any disputes relating to the stoppage of industrial units, adequate market support for the production of sick small units etc. Government should also take initiative in proper and continuous running of the unit by providing necessary infrastructure facilities, such as continuous power supply, water supply etc.

4. Management :

Should cooperate by forgoing interest on unsecured loans/deposits brought by itself or friends and

relatives, write off the loan and bringing in fresh funds as may be decided under the package.

5. Labour :

May contribute voluntarily by agreeing not to raise any fresh demand for an agreed period, to raise their wages, increased in bonus etc.

6. Creditors ;

May agree to a phased liquidation of past dues, desist from filing winding up petitions extend cooperation at creditors meetings to any scheme of reconstruction or merger etc.

7. The loss before interest and depreciation of the sick small scale units may be shared between the banks and financial institutions on a certain indicated bases.

8. Advances to sick small scale units under rehabilitation programme of banks and financial institutions may be exempted from the incidence of interest tax.

9. In respect of Agro-based industries assistance of National bank of Agriculture and Rural Development (NABARD) and the commercial banks may take up sectoral studies.

10. Lastly, the banks should view the incidence of sickness in small industry seriously and must take initiation in speedy sanctioning of loans disbursement of loans and avoid unfavourable policy and delay in decision-making.